

ITEM 2. INVESTMENTS HELD AS AT 30 NOVEMBER 2008

FILE NO: S034147

SUMMARY

This report provides details of Council's Investment Portfolio as at 30 November 2008.

Council's total Investment and Cash position stands at \$417.1M, with investments earning interest of \$2.6M for the month of November.

Council achieved an annualised monthly return of 6.78% for November, below the UBSA Bank Bill Index of 6.85%. Investment returns continue to decline in line with the significant interest rate cuts in October and November. While the benchmark index also reflects these cuts, it also rises in the actual months that the Reserve Bank cuts official cash rates, as it reflects the increased capital value of the existing higher yield investments within the benchmark portfolio.

Council's annual rolling return of 7.66% also underperformed the UBSA Bank Bill Index of 7.80% as at November, reflecting the growing proportion of the portfolio that is now invested in shorter term lower yielding term deposits.

Legislation enacting the deposit and wholesale funding guarantees for Australian approved deposit-taking institutions (ADIs) was finally passed in the last week of November.

The ADIs (banks, building societies and credit unions) continue to consider the details and financial implications of the guarantee, and how its application will affect their competitive positions and customers. ADIs are yet to finalise and communicate their pricing decisions and, until the outcome is clearer, staff will continue to monitor the situation and gather further information before determining if changes are required to Council's current Investment Policy and Strategy.

RECOMMENDATION

It is resolved that the Investment Report as at 30 November 2008 be received and noted.

ATTACHMENTS

Attachment A: Register of Investments and Cash as at 30 November 2008.

Attachment B: Investment Performance as at 30 November 2008.

BACKGROUND

1. In accordance with the principles of financial management, cash that is surplus to Council's immediate requirements is invested within acceptable risk parameters to optimise interest income while ensuring the security of these funds.
2. Surplus cash is only invested in authorised investments that are compliant with governing legislation and Council's Investment Policy and Strategy.
3. The benchmark performance goal of Council's Investment Policy and Strategy is to surpass the UBSA Bank Bill Index.
4. Council's total Investment and Cash position as at 30 November 2008 is \$417.1M, a decrease of \$20.1M from the \$437.2M reported at 31 October 2008, reflecting property acquisitions, capital works and other operational payments, partially offset by rate income receipts. A schedule detailing all of Council's investments as at the end of November is provided at Attachment A.
5. Council's monthly annualised net return decreased from 7.88% in October to 6.78% for November, reflecting the impact of 1% and 0.75% cut to official interest rates in October and November respectively. This result fell short of the benchmark UBSA Bank Bill Index of 6.85%.
6. The Bank Bill Index is designed to replicate a trading portfolio of short term fixed income securities. Movements in the index reflect interest returns achieved along with changes in the market value of these fixed income securities within the portfolio for the month. In months where the Reserve Bank cuts official rates, the index reflects the increased capital value of the existing higher yield investments within the portfolio relative to the lower investment returns available within the market at the time of the rate cut. The index would normally be expected to settle over the next two months succeeding a rate cut as these higher yielding securities mature over that period.
7. Council's annual rolling return for November 2008 of 7.66% has also underperformed the UBSA Bank Bill Index (12 months) of 7.80%. This result reflects the increasing proportion of lower yield term deposits in the portfolio, with average lives extending less than 4 months, compared to the higher returns that were received over the entire 12 month period.
8. As flagged during the June review of the Investment Policy and Strategy, and again in the October Investment Report, the UBSA 90 day Bank Bill Index is no longer considered to be the most appropriate benchmark measure for Council's investment portfolio returns. Our investment opportunities are significantly constrained by the Minister's stringent Investment Order, and we tend to hold rather than actively trade our securities, so a mark to market for a 90 day period index can be quite misleading.
9. In contrast, the 30 day Bank Bill Rate (BBR) Index indicates the risk free return that is available in the market and therefore provides a better measure of whether Council's strategic management of its investment portfolio outperforms a risk free strategy. Attachment B illustrates Council's monthly returns annualised and the 12 month rolling return achieved for the portfolio, against both benchmark indicators, as at November 2008.

10. Legislation enacting the deposit and wholesale funding guarantees for Australian approved deposit-taking institutions (ADIs) was passed in the last week of November. The guarantee facility carries an insurance premium fee from 28 November, with higher premiums charged to institution with lower credit ratings to reflect the increased risk. A fee-free threshold of \$1M for term deposits is allowed for individual customer of each ADI.
11. The ADIs (banks, building societies and credit unions) continue to consider the details and financial implications of the guarantee, and how its application will affect their competitive positions and customers. Given that the final details have only just been released, a number of ADIs are yet to finalise and communicate their decisions as to how the guarantee will impact their net returns.
12. Until these outcomes are clear, staff will continue to monitor the situation and gather further information before determining what changes may be required to Council's current Investment Policy and Strategy. Consideration will be given to a number of factors including global financial developments, the impact of the government guarantee on investment returns and the risk profiles of the individual ADIs within the current market.

KEY IMPLICATIONS

13. Council's investments accord with the proposed Minister's Investment Order and the Investment Policy and Strategy adopted by Council on 30 June 2008, including the ability to retain grandfathered investments.

FINANCIAL IMPLICATIONS

14. Council's investments earned interest of \$2.7M for the month of November 2008, or \$14.3M YTD, which represents \$2.9M above the YTD interest income budget.
15. The write-off of the Palladin CDO, and provision for the investments with Lehman Bros which is in the process of liquidation, has required recognition of a \$3.2M loss in the current financial year.

RELEVANT LEGISLATION

16. Council is authorised to invest its surplus cash under Section 625 of the Local Government Act 1993.
17. The Local Government (General) Regulation 2005 (clause 212) requires Council to provide a written monthly report of all monies invested, under Section 625 of the Act.
18. Council's Investment Policy and Strategy accord with all the requirements of the Ministerial Investment Order.

CRITICAL DATES / TIME FRAMES

19. A monthly investment report must be submitted for Council's information and review within the following month.

PUBLIC CONSULTATION

20. Consultation is regularly undertaken with a number of fund managers and investment advisers to consider options and ensure that Council continues to maximise its investment return within appropriate risk parameters.

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